

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 06-0059
Sales and Use Tax
For The Tax Period 2002-2004

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

Issues

I. Sales and Use Tax -Imposition of Use Tax on Modular Home Platforms

Authority: IC § 6-2.5-3-2(a), IC § 6-8.1-5-1(b), IC § 6-2.5-5-4, 45 IAC 2.2-5-8(c),(d),(f), *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520 (Ind. 1983).

The taxpayer protests the imposition of use tax on parts used to build modular home platforms.

II. Sales and Use Tax -Imposition of Use Tax on Watches and Forms

Authority: IC § 6-2.5-3-2(a).

The taxpayer protests the imposition of use tax on watches and forms.

III. Tax Administration - Ten Percent Negligence Penalty

Authority: IC § 6-8.1-10-2.1, 45 IAC 15-11-2(b)(c).

The taxpayer protests the imposition of the ten percent negligence penalty.

Statement of Facts

The taxpayer was a corporation that designed, manufactured, and sold modular homes. The taxpayer has manufacturing facilities in Indiana, Kansas, Wisconsin, Pennsylvania, Oregon, and North Carolina. Pursuant to an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional use tax, penalty, and interest against the taxpayer. The taxpayer protested a portion of the assessment of use tax and penalty. A hearing was held and this Letter of Findings results.

I. Sales and Use Tax -Imposition of Use Tax on Modular Home Platform

Discussion

The taxpayer purchased parts that were used to build modular home platforms (MHPs). MHPs are large platforms with wheels. During the construction process, the taxpayer attaches modular home pieces to the MHPs. The homes being built are moved from station to station in the building process on the MHPs. After the conclusion of the production process, a third party delivery company attaches wiring and lights, license plates, and “oversized load” placards to the MHP. The third party then connects the MHP with the attached modular home to its truck cab for delivery to the home site. The department assessed use tax on the materials used to build the MHPs. The taxpayer protested a portion of this assessment.

Pursuant to IC § 6-2.5-3-2(a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. All tax assessments are presumed to be accurate. IC § 6-8.1-5-1(b). The taxpayer bears the burden of proving that any assessment is incorrect. *Id.*

IC § 6-2.5-5-4 provides an exemption from the use tax for tangible personal property directly used in the direct production of the taxpayer’s product. In *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520 (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-8(c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production.

The taxpayer conceded that the MHPs are not used in an exempt manner after they move the modular home out of the production process and ship it to the final construction site. The taxpayer argues that the MHPs are used in an exempt manner during the production process. The first issue to be determined is whether or not the MHPs are used in an exempt manner during the production process.

The taxpayer provided substantial documentation that the MHPs are used as a platform to construct and to move the modular homes being built through the production process. 45 IAC 2.2-5-8(d) describes the production process as beginning “at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form. . . .” Transportation equipment such as forklifts that are used to move work-in-process during the production process are considered as essential and integral to the production process, thus qualifying for exemption. 45 IAC 2.2-5-8(f)(3). The MHPs are first used at the first point of the production process, when the lag bolts are used to attach the floor joists to the MHP. The last point in the production process occurs when the roof and endwall process is completed, squared, and aligned. The MHPs move the product between these points of the production process like a forklift or conveyor belt moves product through a production line. This usage makes the MHPs an essential and integral part of the production process. Therefore, their use in the production process qualifies for the exemption.

The second issue to be determined is the percentage of exempt use as compared to the percentage of taxable use of the MHPs. The taxpayer computed the exempt percentage by comparing the revenues from freight to the revenues from the sales of the modular homes. Using this method, the taxpayer argued that the materials used to build the MHPs qualified for a 98 percent exemption. The taxpayer erred in using this method of calculating the exempt usage. The appropriate method is to compare the amount of time the item is used in a taxable fashion to the amount of time the item is used in an exempt fashion. 45 IAC 2.2-5-8(f)(9). The taxpayer produced documentation showed that the MHPs are used for transporting the modular homes after production for one day out of ten days. Therefore, ten percent of the use is taxable and 90 percent is exempt.

Finding

The taxpayer's protest to the assessment of use tax on parts used to build MHPs is sustained to the extent that the parts qualify for 90 percent exemption.

II. Sales and Use Tax -Imposition of Use Tax on Watches and Forms

Discussion

The taxpayer purchased watches from an out-of-state vendor who had the watches engraved before shipment to the taxpayer's home office in Indiana. The taxpayer later shipped the watches to its various manufacturing facilities as service awards for employees. The taxpayer also bought purchase order forms from out-of-state companies. The forms were charged to and delivered to the home office in Indiana before shipment to the various manufacturing facilities. The taxpayer paid sales tax on the watches and purchase order forms that remained in Indiana. The department assessed use tax on the taxpayer's use of the watches and printed purchase order forms shipped to other states pursuant to IC § 6-2.5-3-2(a). The taxpayer protested these assessments.

The taxpayer argued that the items were not used in Indiana for purposes of the use tax. Rather, the taxpayer argued that the watches were used at the facilities where the watches were given to employees and the purchase order forms were completed to obtain materials. The taxpayer errs in this conclusion. The taxpayer exercised control over the watches and order forms in Indiana by determining where they would be given to employees and utilized for the purchase of supplies. The taxpayer's home office in Indiana actually received the benefit of improved employee loyalty due to the service awards and the sale of product made with supplies ordered on the purchase forms. All of the states where the taxpayer has facilities except for Oregon have a use tax comparable to Indiana's. Had the taxpayer believed at the time it acquired the products that the total benefit went to the local facilities and the items were actually used for use tax purposes in those states, it would have paid use taxes to the various states. The taxpayer did not demonstrate that it had paid use taxes on the watches and purchase order forms to any other states. Since there is no use tax in Oregon, the taxpayer could not have paid use tax on the watches and purchase order forms to that state. The department properly imposed the use tax on the taxpayer's use of the watches and purchase order forms that it shipped to manufacturing facilities in other states.

Finding

The taxpayer's protest is denied.

III. Tax Administration- Ten Percent Negligence Penalty

Discussion

The taxpayer protests the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at 45 IAC 15-11-2(c) as follows:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

The taxpayer provided substantial documentation to indicate that its failure to pay the assessed use tax was due to reasonable cause rather than negligence.

Finding

The taxpayer's protest is sustained.

KMA/BK/DK/06/14/08